

LARGE-CAP/GLOBALLY DOMINANT COMMENTARY LETTER SECOND QUARTER 2008

OVERVIEW

Ignoring the mountain-shaped path that equity markets followed in the second quarter, and instead considering only the net result, could mistakenly induce a sense of straightforwardness to what has just ensued. On balance, equity markets did not move all that far in the quarter. Stating simply that the S&P 100 Global Index was down 4.72 percentage points and the S&P 500 was down 2.73 percentage points, does little to tell the true story of the quarter. Such a simple interpretation ignores the story of how equity markets were driven by a set of seemingly bifurcated emotions within the period; one of “the worst is behind us” optimism, and another of “the worst is yet to come” nervousness.

Only those that watched closely day in and day out can understand that it was, in truth, a very challenging quarter for investors. What began with great hope, quickly turned sour about midway through the quarter, leading to a sharp decline in the month of June. Behind the pullback was an alarming concoction, consisting of higher oil prices, stagnating wages, deteriorating employment, and tightening credit. The troublesome situation forced the Fed to walk a fine line in the quarter, balancing the risks of slowing growth with the perceived risks of accelerating inflation. It became cliché for some to opine that the Fed had shot too early, leaving it up to the beleaguered U.S. consumer to pull the economy out of a looming recession. Others argued that the more germane risks were a weaker dollar and accelerating inflation. As you can tell from our Economic and Investment Outlook letter we believe that the Fed has worked a reasonable balance, but the Fed’s newly media-bestowed caricature could be described as dumbfounded with a startlingly empty quiver on its back – just as the economy seemed to need help the most. The resultant unease regarding the Fed’s and the Treasury’s ability to guide us out of this mess weighed heavily on stocks in the second quarter. In the end, both the S&P 100 Global and the S&P 500 Index were down more than 800 basis points in June alone, more than fully erasing the gains that had accumulated during the first two months of the second quarter. Year to date, this leaves the S&P 100 Global down just over 14.3%, while the S&P 500 Index is down close to 12%.

PORTFOLIO PERFORMANCE

As the second quarter got under way, and equities rallied strongly, we remained of the contention that our defensive posture was more appropriate given a long term outlook. We were unable to ignore the rather telling data pointing, convincingly, in the direction of a potential consumer-led recession. Rallying commodity prices, particularly energy, continued to pressure consumers’ pocket books, while a deteriorating employment backdrop and tightening credit made it more challenging than ever for consumers to keep consuming. As equity markets rolled over midway through the quarter and began their sharp June descent, our decision to adhere to the long-term picture seemed increasingly wise. Unfortunately, some of our usually defensive consumer staples did not respond accordingly, thereby putting unexpected pressure on our second quarter performance. Our unwillingness to jump into what we view as an overpriced, but still climbing energy sector, and a quickly sinking, but still unnerving financial sector largely offset each other. Remaining overweight



in the healthcare sector provided a small boost, but in the end it was not enough to offset the curious consumer staple drag, the energy underexposure, and a few initial weak performers in which we opportunistically initiated a bit too early as the market endured its June descent. The sell-off left most client portfolios trailing the indices for the quarter, but still out-performing the benchmarks year-to-date. Importantly, we are pleased to report that through the first 20 days of the third quarter, most client portfolios are beating the respective indices by an incremental 3 percentage points.

As equity markets cascade lower, we naturally see additional opportunities for long-term investments. The second quarter was no exception, as we capitalized on several great buying opportunities. Obviously, we make all possible efforts to buy at the lowest price possible, but buying every stock at the lowest price every time is near impossible as emotions swing around fundamental realities. As for the individual stocks that reflected negatively on our second quarter performance, we remain optimistic about their long-term theses, and expect amplified recoveries in these names when equity markets bounce back. We reevaluate our long-term theses on a consistent basis, and if any parts of our theses are ever to come under duress, whether the thesis is for the broad market, a specific sector, or an individual company, we immediately look to take action. As of now, we remain comfortable given our more defensive stance in general. Based on our outlook, however, we have begun shifting to a more offensive posture by targeting discounts in certain niche areas of the market.

Again, our decision to slow the rate of change in transforming the Large-Cap/Globally Dominant Portfolio into a more offensive portfolio with more financials and consumer discretionary names has helped us avoid near term losses. While we are prepared to capitalize on near-term discounts in these sectors of the market, we remain comfortable, for now, being overweight the more essential areas of the economy, such as consumer staples and health care. In fact, the recent underperformance of the staples, despite the challenging second quarter gives us optimism that we are already well situated to take advantage of a reversion to the mean in the coming months. We remain unenthusiastic with regard to what we see as an overpriced energy sector, but are gaining comfort with the notion of testing the waters in the heavily beaten financial sector, where early actions will undoubtedly be decidedly prudent.

LOOKING AHEAD

As discussed in the Economic and Investment Outlook, we can't rule out further downside in U.S. equity markets in the coming months. The U.S. consumer is facing an undeniably challenging path, spearheaded by a clash between escalating costs of living and declining wealth/credit availability. In light of the domestic challenges, the Large-Cap/Globally Dominant strategy will continue to concentrate on finding high-quality, industry-leading companies with broad international exposure. Sector allocation will remain a central area of focus, but company specific factors, such as international exposure, essential products, and healthy balance sheets, will play an equally important role in how we allocate sectors in the portfolio. We continue to look for companies that possess sustainable competitive advantages, consistent financial results, and unquestioned market leadership, preferably with revenue growth in multiple international marketplaces. Many of the companies appropriate for this strategy are household names with mature and highly recognizable brands, but if we see an unheralded competitive advantage that we



feel will eventually propel a company into a position of market dominance, we will actively consider it.

Given the tumultuous market environment, ICM's team remains committed to monitoring the global macroeconomic environment, looking for cues that either substantiate or refute the current pillars of our strategy and outlook. For now, we feel confident that a relatively defensive posture remains sensible. However, being nearly a year into the current bear market, we are actively looking for the right time and appropriate path to position ourselves for an eventual recovery in equity markets. As has been the case in the past, this will occasionally involve opportunistically buying or selling long-term positions as overly-emotional markets create discounts or premiums to our perceived fair value. As always, our goal remains to allow our clients the opportunity for participation in a high-quality portfolio comprised of companies that provide global representation in some of the most attractive markets throughout the world.

We request that clients advise ICM in the event that there are any changes in their investment objectives, financial situation, or whether they wish to impose or modify restrictions on the management of their account. Please call ICM at 800.488.4075 or visit our Web site, www.icmasset.com, if you have any questions or need additional information.

